No. 22,183

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

ROY O. DARBY and EDNA F. DARBY,

Appellees.

On Appeal From the Judgment of the United States District Court for the Central District of California.

BRIEF FOR APPELLEES.

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No. 22,483

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

ROY O. DISNEY and EDNA F. DISNEY,

Appellees.

On Appeal From the Judgment of the United States District Court for the Central District of California.

BRIEF FOR APPELLEES.

Preliminary Statement.

Appellees, Roy O. Disney and Edna F. Disney, commenced the instant action to recover a refund of certain federal income tax deficiencies alleged to have been illegally or erroneously assessed by appellant and overpaid by appellees for the years 1962 and 1963. Jurisdiction was conferred on the District Court by 28 U.S.C. §1346. The District Court filed its Opinion on May 3, 1967 (reported at 267 F. Supp. 1) and its Findings of Fact and Conclusions of Law on July 7, 1967. [I-R. 136, 144, 152.][1]

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[1]For the sake of convenience and clarity, appellees have adopted the designations to the record used in appellant's brief. "I-R." re-

(This footnote is continued on the next page)

The appellant, United States of America, appeals from the portion of the District Court's decision and judgment which held appellees were entitled to a refund of the tax deficiencies paid by reason of the inclusion in their taxable income of sums received by appellee, Roy O. Disney, as reimbursement of travel expenses of his wife, Edna F. Disney, when she accompanied him on certain business trips. Other issues involved in the action below pertaining to the deductibility of exercise equipment and payments to Mr. Disney's secretary are not involved in this Appeal.

Statement of Facts.

During the taxable years 1962 and 1963, appellee, Roy O. Disney, was President, Chairman of the Board, a Director and a member of the Executive Committee of Walt Disney Productions (hereinafter called "WDP") which posts he held at the time of the trial of this case. [II-R. 16-17.]

WDP is a publically held corporation whose stock is listed on the New York Stock Exchange. [I-R. 89.]

WDP's activities are world-wide. Its income is derived from theatrical distribution of motion pictures, both domestically and abroad, with foreign distribution accounting for approximately 35 per cent of the company's gross film earnings. Television programs are licensed around the world. Other segments of the business include character merchandising (*i.e.*, marketing such items as children's clothing, dolls and games

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fers to Volume I of the Transcript of Record consisting of the various pleadings and papers filed with the Clerk of the District Court; "II-R." and "III-R." refer to the two volumes which comprise the Reporter's Transcript of Proceedings.

modeled after Disney characters), publishing, music, and distribution of 16 millimeter motion picture films to schools and other non-theatrical markets. [I-R. 146.]

The company sells magazines in 23 countries, and has contracts with 59 publishers around the world. It has subsidiaries, representatives, and licensees in 58 foreign countries. [I-R. 146.]

During the years in question, WDP had a distributing company in England and in France. In countries where the volume was insufficient to warrant a separate organization, the company distributed through such companies as Metro-Goldwyn-Mayer and J. Arthur Rank. [II-R. 27.] In 1962 the company had recently bought the old RKO Company of Japan and had set up its own distribution and selling organization in Japan. [II-R. 33.]

Mr. Disney and other company executives are required to make numerous business trips within the United States and abroad in the furtherance of the company's far-flung operations. The trips involve not only business meetings, conferences and conventions attended primarily by men, but also screenings, receptions, press conferences, dinners, and numberous social engagements with people in the industry at which women are in attendance. [I-R. 147; II-R. 26, 30-32, 50-51, 91-92.]

There is a rapport and feeling of fellowship among people in show business throughout the world. Reciprocal entertainment and social contact on business trips is expected and is an important part of building and maintaining good will. [II-R. 57-58, 103-105.] Accordingly, many people and firms in the industry, in-

cluding WDP, deem it advisable from a business standpoint that wives accompany their husbands on any protracted business trip. [I-R. 147; II-R. 82-85.]

In addition to helping maintain general good will in the industry, the practice of having wives accompany their husbands on business trips was considered particularly important to WDP from a publicity standpoint because of the special position it occupied in the industry. WDP is regarded as being somewhat unique in the motion picture and entertainment business in that it has specialized in the making of "wholesome entertainment" designed for appeal to the entire family. Many of its pictures are based upon the ideals of Americanism and the home. Hence the company's officers and directors have always been extremely conscious of the image which the company conveyed to the public. Since individuals identified with WDP are frequently in the public eye, its management believes that it serves to enhance the company's image if its representatives travel with their wives. [I-R. 146-147; II-R. 18-19. 82-83; III-R. 234-235, 240-241.]

For these reasons, WDP has for many years paid the expenses of the wives of executives and salesmen who accompany their husbands on extended business trips and has virtually insisted on the wives' presence on trips where it believed such presence would further the company's interests. [I-R. 147; II-R. 18-19, 57-58.][2]

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[2]Although a formal resolution of the Board of Directors stating the company's position regarding reimbursement of travel expenses for wives was not adopted until 1965, it is clear that such resolution expressed a standing policy which management had recognized and followed for many years. [Ex. I; II-R. 22-23, 57-58; III-R. 233, 241-242.]

In his capacity as chief administrative officer of WDP, Mr. Disney makes regular trips to Europe, primarily in the winter, to meet with representatives of the company and with distributors, licensees, and exhibitors, as well as with persons in finance, the press, governmental officials, and dignitaries of the United States and other countries where the company has business interests. Mr. Disney goes to Europe in the winter because that is the time of year when people to be contacted are generally available. It has always been Mr. Disney's custom, in conformity with corporate policy, to have Mrs. Disney accompany him on such trips whenever possible. [I-R. 146-147; II-R. 22, 57-58, 62.]

On such trips there are newspaper interviews and photographs in which Mrs. Disney appears with Mr. Disney. Management of the company believes Mrs. Disney's presence invites additional publicity for the women's pages and enhances the image of the company as a disseminator of family entertainment. Mrs. Disney also attends various dinners, social functions, film screenings, and other gatherings of employees, exhibitors, distributors, other business associates, the press, and the public. [I-R. 147.] There are many women present at these functions, and Mrs. Disney's presence is helpful to Mr. Disney and WDP. [II-R. 26.] She helps entertain at the various social gatherings, takes telephone messages during the day while Mr. Disney is attending meetings, makes arrangements for different functions, invites guests, and is generally available to assist Mr. Disney in any way she can. [II-R. 91-92, 94, 140; III-R. 168-169.]

The company also has a big staff scattered around the world. [II-R. 105.] Mrs. Disney is very helpful in

maintaining good organization relations. She sends Christmas cards, remembers new babies or weddings of children of members of the Disney organization or important exhibitors or publishers whom she has met on business trips. [II-R. 55.]

In 1962 and 1963 Mr. Disney made three business trips outside the country and one trip in the United States of the type described above. He was accompanied by Mrs. Disney pursuant to company policy and both Mr. and Mrs. Disney's expenses on each trip were paid by WDP. The proper tax treatment of Mrs. Disney's expenses on these four trips is the subject of this litigation. [I-R. 89, 93.]

The first trip was Mr. Disney's usual periodic trip to Europe. He and Mrs. Disney were gone about three weeks in January of 1962 and went to Paris and London. The District Court found this was a business trip. [I-R. 147.] It was for the purpose of gathering the sales forces in London and Paris, and holding screenings of the company's products for exhibitors. [II-R. 24.] Mr. Disney took his wife because she was helpful to him on such trips; there are many women at these showings and there are many women theatre operators. [II-R. 26.]

Later in 1962, Mr. and Mrs. Disney made a three-month world tour on WDP business. The expenses of both Mr. and Mrs. Disney were reimbursed by the company. The Disneys were accompanied by Mrs. Disney's brother-in-law and sister, the Vogels, the latter traveling at their own expense. [I-R. 148.] Although the trip was a vacation for the Vogels, the government concedes that it was a business trip for Mr. Disney.

(Br. pp. 4-5.) The District Court found that any side trips taken by Mr. and Mrs. Disney with the Vogels were merely incidental to the business purpose. They were taken on week-ends and days when persons with whom Mr. Disney wished to transact business were not available. [I-R. 148; II-R. 45.]

On this 1962 world tour, Mrs. Disney helped and supplemented Mr. Disney's work. [II-R. 31.] She attended screening and receptions. [II-R. 30-31.] She was present and interviewed at press conferences. [II-R. 31-32.] At each stop on the tour, she attended good-will visits to various people in the industry, social gatherings which followed business meetings and assisted Mr. Disney in hosting and entertaining exhibitors and people with whom Mr. Disney was transacting business. [II-R. 35-54.]

In 1963 Mr. and Mrs. Disney traveled to New York and Europe between January 4 and February 14 on their regular business trip on behalf of WDP. In addition to their normal activities on such trips, there were conferences dealing with problems of operating and selling in the Common Market. The Disneys also attended a publishers' convention in Italy on this trip. [I-R. 148; II-R. 59-62.]

Finally, in August of 1963 the Disneys made a trip to Colorado, Wisconsin and New York along with Mr. Disney's brother, Walt, and his wife. On this trip, there were several business meetings and Mrs. Disney engaged in the attendant social activities with members of the Disney organization and other people with whom the company had business dealings. [II-R. 62-65.][3]

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[3]During this trip, Mr. Disney was called upon to make an unexpected trip to London. Mrs. Disney remained in New York

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With respect to all of the foregoing trips, WDP made advances or reimbursements to cover the travel expenses of Mr. and Mrs. Disney. Mr. and Mrs. Disney kept careful records of their expenditures and made accountings to the company for each of the trips segregating the business expenditures from those which were purely personal. The Disneys reimbursed the company for all personal expenditures. [I-R. 89-90, 95-106, 148-149; II-R. 65-66, 109.]

Mr. and Mrs. Disney filed timely joint income tax returns for the years 1962 and 1963 and paid the tax shown to be due thereon. They did not report therein any amounts attributable to the travel expenses which WDP paid for Mr. and Mrs. Disney on the trips in question. [I-R. 87-88, 107-121.]

Upon audit of appellees' tax returns for said years, the Commissioner of Internal Revenue determined that all travel expenses incurred by Mrs. Disney were personal in nature and that her presence on the subject trips did not have a bona fide business purposes. Accordingly, the amounts paid by WDP for Mrs. Disney's travel expenses were treated by the Commissioner as additional taxable income to Mr. Disney. [I-R. 90-91.]

The deficiencies attributable to the inclusion of Mrs. Disney's reimbursed travel expenses in taxable income

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for a week until Mr. Disney returned. The District Court found Mrs. Disney's stay in New York during this period had no business purpose and her reimbursed expenses were not excludable from taxable income. Appellees do not dispute this finding and such expenses are not involved in this Appeal.

for the years 1962 and 1963 were paid by appellees on or about May 21, 1965. Interest on said deficiencies was paid July 23, 1965. Appellees filed timely claims for refund with the District Director on August 3, 1965. [I-R. 88.]

By letter dated February 1, 1966, Appellees were notified by the District Director thst their claims for refund disclosed no basis for reducing their income tax liability for the years in question. On February 4, 1966, this action was timely commenced. [I-R. 88-89.][4]

Following the trial in this case, the District Court's findings included the following:

> "21. Mrs. Disney's presence on the round the world trip, the two trips to Europe and the domestic trip served to enhance the corporate image abroad, she assisted her husband in business activities, and her travel was for a bona fide business purpose. The payment of Mrs. Disney's travel expenses by Walt Disney Productions was not intended to be compensory in nature. Reimbursement of Mrs. Disney's travel expenses was properly excluded from gross income of the taxpayers." [I-R. 149.]

Accordingly, the Court concluded appellees were entitled to refunds for the years 1962 and 1963 based upon the improper inclusion in taxable income of Mrs. Disney's travel expenses paid by WDP. Judgment was entered accordingly. [I-R. 150-153.]

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[4]On April 12, 1966, the Commissioner of Internal Revenue issued a statutory notice of rejection of said claims. [I-R. 89.] However, so far as this action is concerned, such formality was superfluous.

Questions Presented.

Neither the amount of Mrs. Disney's travel expenses nor the amount of tax attributable thereto are in dispute. The sole issue is whether the payment of such expenses by WDP is taxable to Mr. Disney. Thus the specific questions presented are as follows:

1. Does the record sustain the finding of the District Court that Mrs. Disney's presence on the trips in question was for a bona fide business purpose and that the payment of her travel expenses by WDP was not intended to be compensatory in nature?
2. If the answer to the first question is in the affirmative, did the District Court correctly hold that Mrs. Disney's travel expenses paid by WDP were not includible in Mr. Disney's gross income?
3. If such amounts were includible in Mr. Disney's gross income, as appellant contends, were they deductible as ordinary and necessary business expenses?

Statutes and Regulations Involved.

The relevant statutes and regulations are set out in the bodies of this brief and appellant's brief, and in Appendix A to appellant's brief.

Summary of Argument.

Appellees contend that the portion of the judgment appealed from was entirely correct and should be affirmed. Mrs. Disney's reimbursed travel expenses should not have been taxed to appellees and the resulting in-

come tax deficiencies were illegally and erroneously collected from them. Accordingly, appellees are entitled to a refund of the overpaid taxes, with interest, as adjudged by the District Court.

This result is proper because Mrs. Disney's reimbursed travel expenses, incurred on behalf of WDP, were not includible in appellees' gross income under settled principles of law. To be includible, the reimbursement must be in the nature of compensation. This is a question of fact and the District Court expressly found that reimbursement of Mrs. Disney's travel expenses was not compensatory. Such finding is supported by substantial evidence.

But even if the reimbursed expenses were technically includible in income, as appellant contends, the result would be no different. In such event, appellees would certainly be entitled to deduct them as ordinary and necessary business expenses. This follows from the fact that the District Court found Mrs. Disney's presence on the trips had a bona fide business purpose. Again, such finding is supported by substantial evidence.

Appellant's attack on these findings is based upon a fundamental misconception as to the nature of the business purpose which must be met for the reimbursed travel expenses to be non-taxable. Appellant has the erroneous notion it is immaterial that Mrs. Disney accompanied her husband on the trips because WDP's management believed it enhanced the company's public image and helped maintain good will among the company's organization and people with whom they had business dealings. Far from being im-

material, such purpose alone precludes her reimbursed travel expenses from being taxed to appellees regardless of which procedural approach is followed.

The authorities cited, including those relied upon by appellant, make it clear that the critical issue is whether the dominant motive or primary purpose for the trip is business or pleasure. If the primary purpose for the wife, as well as her husband, is to engage in activities which the husband's employer feel will enhance the company's image, the wife's travel costs are not really personal expenses but business expenses incurred on behalf of the employer. Hence, payment of such expenses by the employer is deemed not to be compensation, and most authorities hold the payments are not to be included in income. If they are included, they are held to be deductible.

It is submitted that the findings and record in this case establish conclusively that the trips in question were not vacations to Mrs. Disney—the dominant motive and primary purpose for the trips was business not pleasure. Hence, payment of her travel expenses, incurred on behalf of WDP for legitimate business reasons, was not taxable compensation or income to appellees.

ARGUMENT.

I.

Because Mrs. Disney Accompanied Her Husband for a Bona Fide Business Purpose and Payment of Her Travel Expenses Was Not Intended as Compensation, Such Payments Are Not Includible in Mr. Disney's Gross Income.

As stated previously, the District Court found that Mrs. Disney's travel with her husband on the subject business trips was for a bona fide business purpose and payment of her expenses by WDP was not intended to be compensatory in nature. [I-R. 149.] Accordingly, the court concluded such payment did not constitute income to Mr. Disney. Appellees contend that the evidence and applicable principles of law fully support that decision. Appellant's arguments to the contrary are patently untenable.

Appellant argues that under the broad general concept of "gross income" embodied in Section 61(a) of the Internal Revenue Code, reimbursement of Mrs. Disney's travel expenses necessarily resulted in the realization of income by Mr. Disney. As appellant sees it, the real issue is whether Mr. Disney is entitled to a *deduction* for such expenses as ordinary and necessary expenses incurred in carrying on his business under Section 162(a)(2) of the Code. Appellant insists that a distinction must be drawn between Mr. Disney's business and that of his employer, WDP; and that although Mr. Disney's own expenses are deductible, he is not entitled to a deduction for his wife's expenses even if his wife's travel served a bona fide business purpose for WDP.

Appellant's analysis is demonstrably faulty. The authorities it cites for inclusion of Mrs. Disney's reimbursed expenses in gross income under Section 61 (a) are plainly distinguishable and not controlling in light of the District Court's findings in the instant case. In each of the cases appellant relies upon, it was expressly found that the payments under scrutiny were a form of *compensation* to the taxpayer for services. By contrast, the lower court here expressly found that the reimbursement of Mrs. Disney's travel expenses was not intended to be compensatory. [Find. 21, I-R. 149.]

Appellant challenges this finding on the ground that there was no allegation or evidence that WDP's payment of the expenses was intended as a "gift." (Br. pp. 11-12.) Such argument misses the point completely. Reimbursement of a taxpayer's expenses need not be classified as a gift to be excluded from gross income where such reimbursement is noncompensatory. The test, under settled principles of law, is whether the reimbursed expenses are *personal* expenses of the taxpayer or expenses which he incurred *on behalf of his employer* in the course of his employment. Whereas reimbursement of a taxpayer's personal expenses results in the receipt of income, reimbursement of expenses incurred primarily for the benefit of his employer does not. *Mertens, Law of Federal Income Taxation,* Section 6.04, Ch. 6, pp. 17-18.

It has long been held that reimbursement of an employee's actual travel expenses incurred while engaged in business on behalf of his employer—especially where he accounts to his employer for such expenses—does not result in income to the employee. *J. S. Cullinan,*

5 B.T.A. 996 (1927) (Acq.); *Herbert A. Chianese,* 9 T.C.M. 627 (1950); *Siegfried v. United States,* 55-2 U.S.T.C. Para. 9531 (N.D. Okla. 1955); *Sanitary Farms Dairy,* 25 T.C. 463 (1955).

In *Sanitary Farms Dairy, Inc., supra,* a dairy corporation sent two officers on an African hunting trip and paid their expenses. The Tax Court found from the evidence that the trip was essentially a business trip, rather than a pleasure trip, and therefore held that the payment of the officers' expenses was deductible by the corporation and *did not constitute income to the individuals.* The following language from the Court's Opinion (at p. 468) is appropriate here:

> "No part of that cost is taxable to the Brocks as personal travel and pleasure expense of theirs. They admittedly enjoyed hunting, but enjoyment of one's work does not make that work a mere personal hobby or the cost of a hunting trip income to the hunter. There is evidence that this trip represented hard work on the part of the Brocks, undertaken for the benefit of the dairy, rather than as frolic of their own."

The same rationale has been applied to hold that a partner who is reimbursed for travel expenses incurred on behalf of his partnership does not thereby realize income. *Robert L. Gray,* 10 T.C. 590 (1948).

An analogous situation involves the tax treatment of a taxpayer's moving expenses which are reimbursed by his employer when the move is for the employer's benefit. The recent Tax Court decision in *Homer H. Starr,* 46 T.C. 743 (1966) is illustrative. There a taxpayer received from his employer moving expenses in-

cidental to a transfer to a new post. The court found that such reimbursed costs were incurred primarily for the benefit of the employer and hence were not compensatory. Accordingly, such reimbursed expenses were held not includible in gross income. The court said (at pp. 744-745):

> "Though it is no longer open to serious question that the concept of 'gross income' embodied in section 61(a) is 'all inclusive,' *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 432 (1955), it is a well established principle that a reimbursement of costs incurred by an existing employee primarily for the benefit of the employer is not compensatory in nature and is excludable from the employee's gross income. *John E. Cavanagh*, 36 T.C. 300 (1961)."

The Court further stated (at p. 745):

> "[I]t is obvious that the criteria used to determine whether a reimbursement is compensatory are in no way dependent upon considerations relevant to the issue of the deductibility of the expense by the employee."

This concept—that reimbursed expenses incurred primarily for the benefit of one's employer do not constitute income—is certainly recognized by the Commissioner of Internal Revenue in his own rulings with respect to moving expenses. In Rev. Rul. 54-429, 1954-2 C.B. 53, it was held that amounts received by an employee as reimbursement for moving himself and his immediate family, because of a transfer by his employer, were not includible in his gross income under Section 22(a) of the 1939 Internal Revenue Code (which cor-

responds to Section 61(a) of the 1954 Code). In so holding, the ruling states:

> "The payment or reimbursement by an employer of the cost of moving an employee, his immediate family, household goods, and personal effects from one place of employment to another permanent place of employment, primarily for the benefit of the employer, is not compensatory in nature. There is no essential difference between a payment of such cost directly by the employer and a payment by the employee and subsequent reimbursement by the employer."

The Commissioner subsequently ruled to the same effect with respect to Section 61(a) of the 1954 Code in Rev. Rul. 65-158, 1965-1 C.B. 34.

Other examples may be found where the Commissioner of Internal Revenue has recognized in his rulings that amounts paid to a taxpayer to reimburse him for certain travel or living expenses, which he incurred at the request of the one doing the reimbursement, in furtherance of the latter's business, does not result in income to the taxpayer under Section 61(a). See, *e.g.*, Rev. Rul. 62-113, 1962-2 C.B. 10 (reimbursement from church fund for taxpayer-missionary's travel and living expenses while performing services on behalf of and at request of the church); Rev. Rul. 63-77, 1963-1 C.B. 77 (reimbursement of taxpayer's travel expenses received from prospective employer for attending job interview at latter's invitation); Rev. Rul. 67-407, I.R.B. 1967-47 (reimbursement received from hospital for motel bill and other necessary costs of taxpayer and wife where they had to live away from their res-

idence at request of hospital because of research project involving daughter).

In view of the foregoing authorities and rulings, it seems indisputable that reimbursed travel expenses incurred on behalf of a taxpayer's employer cannot properly be regarded as includible in gross income. Such expenses are not the normal personal living expenses of the recipient and are incurred only because the travel is required in pursuance of the employer's business. Hence, they do not compensate the taxpayer or confer upon him any gain; they simply reimburse him for those business expenses of his employer which he has advanced.

Notwithstanding the apparent inconsistency in its position, as compared with other reimbursed expenses, the Treasury Department at one time provided in its regulations that reimbursed travel expenses should be reported by the employee in his gross income and then deducted by him as a business expense. At least one noted tax authority stated that this regulation was of "questionable validity" and "was rarely followed." *Rabkin & Johnson, Federal Income, Gift and Estate Taxation*, Volume 2, Section 1401 (11), pp. 1411A-1411-B. In any event, the regulation was changed prior to the tax years here in question, eliminating the needless procedure of inclusion and deduction if the employee accounted for the expenses to his employer. Regulations, Section 1.162-17(b)(1) reads as follows:

> "The employee need not report on his tax return (either itemized or in total amount) expenses for travel, transportation, entertainment, and similar purposes paid or incurred by him solely for the

benefit of his employer for which he is required to account and does account to his employer and which are charged directly or indirectly to the employer (for example, through credit cards) or for which the employee is paid through advances, reimbursements, or otherwise, provided the total amount of such advances, reimbursements and charges is equal to such expenses. In such a case the taxpayer need only state in his return that the total of amounts charged directly or indirectly to his employer through credit cards or otherwise and received from the employer as advances or reimbursements did not exceed the ordinary and necessary business expenses paid or incurred by the employee."

This regulation was cited by the Tax Court in *William R. Lickert,* 23 T.C.M. 376 (1964), in holding that a taxpayer was not required to report in gross income any amount of reimbursed travel and entertainment expense incurred on behalf of his employer for which he accounted to the employer. The court specifically rejected the government's argument that the taxpayer was required to prove the expenses were proximately related to *his* business, as distinguished from his employer's business.

Appellees believe that even the existing, modified regulation is not logically defensible in requiring an accounting to the employer before a non-compensatory reimbursement of travel expenses is not reportable as income. If the reimbursement does not constitute compensation for services, it simply is not income regardless of whether there is any accounting. But such

point is of only academic importance to the instant case because it is not disputed that appellees did account to WDP for the travel expenses in question. *Hence, it was not necessary to report such expenses as income under the express language of the Commissioner's own regulations.*

Nor does it make any difference that the reimbursed travel expenses in question are those of the *wife* of an employee. The same concept of gross income is involved and the wife's reimbursed expenses may not constitute income for the same reasons that the husband's expenses are excludible. If her travel with her husband is not primarily for pleasure, but for a business purpose of her husband's employer, and payment of her expenses is not intended as compensation, such reimbursement is not income any more than is reimbursement of his expenses. *Allen J. McDonell,* 26 T.C.M. 115 (1967); *Gotcher v. United States,* 259 F. Supp. 340 (E.D. Tex. 1966); *Allenberg Cotton Co., et al. v. United States,* 61-1 U.S.T.C. Para. 9131 (WD. Tenn. 1960); *cf. Warwick v. United States,* 236 F. Supp. 761 (E.D. Va. 1964).

In *Gotcher v. United States, supra*, the taxpayer was a stockholder, officer and general manager of a corporation engaged in the business of selling Volkswagen automobiles as a franchised dealership. In 1959 taxpayer and his wife took a trip to Germany at the invitation of Volkswagen (a German Corporation) pursuant to a program whereby dealers and their wives were taken on expense paid trips in order to tour that company's factories and the facilities of local dealers. The purpose was to educate the dealers and strengthen the Volkswagen family business ties. The wives were

included based upon Volkswagen's belief that American wives exercised a substantial influence in family investments. Since a Volkswagen dealership required a large investment, the company deemed it desirable and advisable for the wife to acquire first hand as much information as possible about her husband's stock in trade.

While the invitation extended to the dealers did not specifically order or require them to take their wives, the Court concluded that such invitations had the practical effect of being an order or directive. The dealers were aware of the desire of Volkswagen that they take their wives on the tour. Therefore, it would only be natural that a dealer receiving an invitation would feel that in the interest of good future relations he was compelled by sound business judgment to accept on behalf of himself and his wife.

The government contended in *Gotcher,* as it contends in the instant case, that the expenses of the tour paid by Volkswagen and the taxpayer's corporate employer constituted income; and although some offsetting deduction was allowed for the husband as an ordinary and necessary business espense, no such deduction was allowed with respect to the wife's expenses. *However, the court held that neither the expenses of the husband nor his wife properly constituted income.* It was found that the principal and dominant purpose of the tour was business, not pleasure; that the tour was not given to dealers as compensation because of any service rendered or performance on the part of the dealers in the operation of their dealerships; that there was a sound business reason for Volkswagen and plaintiff's corporate employer to pay the expenses

of the trip; and that there was a bona fide business purpose for the wife to accompany her husband on the trip. It is submitted that such findings and the following language from the court's Opinion thoroughly refute appellant's position in the instant case:

> "As pointed out by the Supreme Court in Commissioner of Internal Revenue v. Smith, 324 U.S. 177, 181, 65 S. Ct. 591, 593, 89 L. Ed. 830, the definition of gross income in the Internal Revenue Act 'is broad enough to include in taxable income any economic or financial benefit conferred on the employee *as compensation,* whatever the form or mode by which it is effected.' (emphasis supplied) It is clear that in order for an economic or financial benefit to constitute taxable income, it must be in the nature of *compensation.* As the facts above pointed out reflect, the expenses paid trip to Germany was not in any sense of the word compensation to the Plaintiffs. The cases of Patterson v. Thomas (5th Cir. 1961) 289 F.2d 108 and Rudolph v. United States, D.C. 189 F. Supp. 2, affirmed per curiam, 5 Cir., 291 F.2d 841, relied on so heavily by the Government, are not in point. Each of those cases involved an expense paid trip which was principally for pleasure given an employee by the employer because of an outstanding performance on the part of the employee." *Gotcher v. United States, supra,* at 344.[5]

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[5]Unaccountably, appellant stated in its brief that it could only find two cases in which reimbursed travel expenses were excluded from gross income, citing *Allenberg* and *McDonell.* (Br. p. 13.) The *Gotcher* case is squarely in point and was cited in the opinion of the court below in the instant case. Furthermore, appellant offers no explanation as to why the many other cases and rulings cited earlier herein are not equally applicable in principle.

The same result was reached in *Allen J. McDonell, supra.* There a husband and wife were sent on a trip to Hawaii by the husband's employer to accompany winners of the company's incentive sales contest. Part of the objective was to enhance the company's image with the distributors and territorial salesmen who were contest winners. Wives were considered essential participants in the achievement of this objective. The company felt it was impossible for stag salesmen to host a trip for couples. The Tax Court held that the payment of the expenses of the trip by the husband's employer did not constitute income, stating as follows:

> "There is not the slightest suggestion that the trip which the petitioners took was conceived of as disguised remuneration to them. On the contrary, DECO had sound business reasons for them to go. We recognize that the presence of an employer business purpose does not thereby preclude a finding of compensation to the employee. *Patterson v. Thomas, supra.* But such business reasons, when coupled with the equally compelling business circumstances involving these petitioners' participation, made the trip no different from any other business trip requiring their services—including Jeanne, whose duties were substantial and could not have been performed by stag men. Cf. *Gotcher v. United States* [66-2 USTC Para. 9634], 259 F. Supp. 340 (E. D. Tex. 1966); *Warwick v. United States* [64-2 USTC Para. 9864], 236 F. Supp. 761 (E. D. Va. 1964).

> We hold that, under all the facts and circumstances herein, the expenses of the trip are not includable in the gross income of petitioners." *Allen J. McDonell, supra* at 116-117.[6]

The only two cases relied upon by appellant which have held that a wife's reimbursed travel expenses constituted income to her husband are *Patterson v. Thomas,* 289 F. 2d 108 (5th Cir. 1961) and *Rudolph v. United States,* 291 F. 2d 841 (5th Cir. 1961). Neither of those decisions is in conflict with the principles or authorities discussed above. They are easily distinguished from the instant case, just as they were in the *Gotcher* and *McDonell* cases, because of differences in the crucial findings. In both *Patterson* and *Rudolph* the Fifth Circuit Court of Appeals held that expense paid trips to an insurance convention, given by an insurance company to employees and their wives, constituted taxable income to the employees. In each case the travel expenses of *both the husband and wife* were deemed includible in income, with no offsetting deduction, because the dominant or primary purpose of the trip was pleasure rather than business; the trip was a reward or compensation to the employee for his services.[7]

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[6]Appellant mistakenly contends (Br. pp. 13-14) that the *McDonell* case does not represent the position of the Tax Court, citing the case of *Jenkins v. Commissioner,* decided twelve months later. (*Charles J. Jenkins,* 26 T.C.M. 1328 (1967).) A reading of that decision will disclose that it is not in conflict with *McDonell* or the other authorities appellees rely upon. On the contrary, although the court in *Jenkins* stated that a per diem and mileage allowance which had no relation to deductible business travel expenses constituted reportable income, it also expressly recognized that if the allowance is in fact a reimbursement of deductible business travel expenses, it need not be reported.

[7]Circuit Judge John R. Brown dissented in both cases on the ground that the trips should have been held to be for a business purpose.

In the *Rudolph* case, the Supreme Court at first granted *certiorari* but then withdrew it on the ground that the critical issue of "dominant motive" was a finding of fact subject to the "clearly erroneous" rule (Rule 52(a) Federal Rules Civ. Proc.). Accordingly, in a *per curiam* decision, a majority of the Supreme Court did not feel the case was a proper one for review. *Rudolph v. United States,* 370 U.S. 269 (1962).[8]

Thus it is established beyond question from all of the foregoing authorities that if the dominant or primary purpose for an expense paid trip is to engage in business on behalf of the one paying the expenses—*i.e.* it is not a pleasure trip given as a reward for services—payment or reimbursement of the travel expenses does not constitute compensation to the one making the trip. Nor is the result any different when an employee takes his wife with him on such a business trip for his employer, so long as his wife's presence also meets the "dominant purpose" test. This is a question of fact, *Rudolph v. United States,* 370 U.S. 269 (1962).

In the instant case, it has been shown that the trial court found the dominant purpose test for the trips was met as to Mrs. Disney, as well as her husband. [Finds. 12-21, I-R. 148-149.] These findings may not be disturbed on appeal unless it can be shown that they are "clearly erroneous" within the meaning of

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[8]Justice Harlan wrote a separate opinion in which he stated that he would affirm the Court of Appeals on the merits because the dominant purpose of the trip was pleasure, as found by the District Court and sustained by the evidence. Justices Douglas and Black dissented on the ground that expenses paid by an employer for its employees and wives to attend a business convention should not be regarded as income to the employees. Justices Frankfurter and White did not participate in the case.

Rule 52(a) of the Federal Rules of Civil Procedure. In determining whether findings are clearly erroneous this Court made the following statement in *Los Angeles Shipbuilding and Drydock Corp. v. United States,* 289 F. 2d 222, 226 (9th Cir. 1961) which is appropriate here:

> "In considering the government's appeal, it is to be borne in mind that the taxpayer was the prevailing party in the district court, and we must take the view of the evidence most favorable to it. The taxpayer is entitled to the benefit of all favorable inferences from the facts proved. If, when so viewed, there is substantial evidence to sustain the findings, the judgment may not be reversed by this Court unless the trial court was influenced by erroneous views of the law."

This Court has also recognized that determinations as to motive in tax cases are especially within the province of the trier of fact. *Earle v. W. J. Jones & Son,* 200 F. 2d 846 (9th Cir. 1952).

Appellees submit that appellant has completely failed to meet its heavy burden of showing that the District Court's findings are clearly erroneous. On the contrary, there is abundant evidence to support each and every finding.

It cannot be doubted that insofar as WDP was concerned Mrs. Disney went on the trip on its behalf to further the business ends of the company, and not as any kind of reward or compensation to her husband. Mr. Disney and two other directors of WDP testified that it was a corporate policy that wives of executives accompany their husbands on business trips

at the expense of the company because they believed it enhanced the company's image. [II-R. 18-19; III-R. 233-235, 240-242.] An independent expert witness testified that this practice would be especially beneficial to WDP because of the unique family nature of its product. [II-R. 82-85.]

Certainly, corporate directors of a publicly held corporation should be given wide latitude in the exercise of their business judgment as to what will benefit the company. *Cf. Francis X. Heidl,* 23 T.C.M. 27, 28 (1964).

The evidence also amply supports the findings that Mrs. Disney in fact performed the services expected of her on the trip. Although much of it was indeed "social" in nature, as appellant points out, that was precisely the business activity she was supposed to engage in for the company. Her primary function was to act as an emissary of good will by attending press conferences, showings and social engagements. The critical point ignored by appellant is that the socializing was *on behalf of the company*, not Mrs. Disney personally. Hence, the trips were not a vacation. As the court said in *Allen J. McDonell, supra,* at 116, "It was realistically a command performance to work."

Moreover, it should not be overlooked that in addition to the social activities Mrs. Disney was required to perform on behalf of WDP, the District Court also found she assisted Mr. Disney in the performance of *his* business activities. [I-R. 149.] She not only helped him entertain and be entertained, she took telephone messages, made arrangements for different functions, invited guests and generally remained available to assist Mr. Disney in any way he thought

she could be helpful. [II-R. 91-92, 94, 140; III-R. 168-169.]

Appellant places great emphasis on the personal activities of Mrs. Disney on these trips, while trying to minimize the business activities. Of course, both Mrs. Disney and her husband had some free time during which they engaged in personal activities. But it is plain that the trial court regarded such personal activities as merely incidental to the business purpose. [I-R. 148.] Mrs. Disney certainly was not required to refrain from all pleasurable or personal activities in order that her presence on the trips be for a business purpose. All that was necessary was that the *dominant* or *primary* purpose be business. The court concluded it was.

In view of the evidence, findings, and authorities discussed above, appellees submit the District Court's decision was entirely correct. Because Mrs. Disney made the trip on behalf of WDP for a bona fide business purpose and the trip was not compensatory, payment of her expenses cannot properly be regarded as income to Mr. Disney.

II.

Assuming, Arguendo, That the Amounts Paid for Mrs. Disney's Travel Expenses Were Includible in Gross Income, They Were Deductible as Business Expenses.

As indicated in the preceding section of this brief, it is appellees' position that the amounts paid by WDP for Mrs. Disney's travel expenses did not constitute gross income and were not required to be reported by appellees in their income tax returns. However, if it is assumed *arguendo* that such payment of expenses

under the circumstances of this case could somehow be regarded as income to Mr. Disney, as the Government contends, there could be no doubt that appellees would be entitled to an offsetting deduction. Such amounts would plainly qualify as ordinary and necessary business expeses of appellees.

The case of *Warwick v. United States,* 236 F. Supp. 761 (E.D. Va. 1964) is squarely in point. There Mr. Warwick was employed in an executive sales capacity by a corporation. He was also a vice-president and director. Duties of officers in the company included European travel. They were encouraged to have close family relationships with European customers which the company believed projected a favorable corporate image. Mr. Warwick took his wife on such trips at the suggestion of the company's president. Her duties were entirely social; she was to assist her husband in establishing friendly intimate relationships with the customers by being congenial and by entertaining customers and being entertained by them with her husband.

After distinguishing *Patterson v. Thomas, supra,* on the ground that the primary purpose of the trip involved there was pleasure, the court held that Mrs. Warwick's reimbursed expenses, though includible in income, were deductible as ordinary and necessary business expenses. The court's cogent reasoning is set forth in the following excerpt from its opinion:

> "The Treasury Regulations on Income tax, 1954 Code, Section 1.162-2 provide in part:
>
> > 'Only such traveling expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted.'

Subparagraph (c) 'Where a taxpayer's wife accompanies him on a business trip, expenses attributable to her travel are not deductible unless it can be adequately shown that the wife's presence on the trip has a bona fide business purpose. The wife's performance of some incidental service does not cause her expenses to qualify as deductible business expenses.'

In Revenue Rulings, 55-57, 1955, Cumulative Bulletin 315, it is reported:

'Advice has been requested relative to the deductibility of amounts expended by a taxpayer for the travel expenses of his wife who accompanies him on a business trip or to a business convention.'

Thereafter, the text cites certain portions of the Code, and goes on to say:

'Where a wife accompanies her husband on a business trip or to a business convention the Code and Regulations as cited above require a showing that her presence serves a bona fide business purpose, i.e., is not merely for her pleasure or vacation, but is directly attributable to the husband's business and necessary to the conduct thereof.'

We all know that the word, 'necessary,' as used in these codes, regulations, bulletins, and cases, does not mean absolutely necessary. It is a relative word. Sometimes it has been defined as appropriate, sometimes as substantially necessary, or qualified in some other way.

The Court concludes that the purpose of Mrs. Warwick's trips was not merely for her pleasure or vacation. They were neither pleasure nor vacation trips in any sense of the words.

Her husband's trips, of course, were business trips.

The amount expended on her behalf was reasonable.

The only reason she went was because of her husband's business. Her trip was directly attributable to her husband's business, and it was appropriate to the conduct of his business. It assisted him in his business and assisted in the production of his income.

The Court has reached this conclusion in part from the very unusual position that Mr. Warwick occupies in the business world, and the unusual nature of Universal's business.

Her trips differed from those of a wife who accompanies an ordinary salesman while he calls on the trade, or of a wife who accompanies her husband to Europe on only a single trip.

It follows that the deduction in 1958 was proper.

The parties have stipulated that the issue pertaining to the 1959 taxes is whether Mr. and Mrs. Warwick 'properly excluded from their 1959 income Mrs. Warwick's travel expenses of $2,003.82 and are therefore entitled to a refund of $1.480.14 plus interest from April 15. 1963.' The evidence discloses that Universal reimbursed Mr. Warwick for the 1959 expenses. Instead of including this in his gross income and then deducting the amount

of the expenses, he simply excluded the amount of the reimbursement and made no deduction.

The Court is of the opinion that the amount of the reimbursement should have been included in gross income and Mrs. Warwick's expenses are properly allowable as a deduction." (Emphasis added.)

Warwick v. United States, supra, at 767.

Appellees disagree with this decision only to the extent it held the reimbursed expenses should first be included in income and then deducted. On that question, appellees believe the cases cited in the preceding section of this brief are controlling. The court in *Warwick* did not discuss its reasons for believing the income should be included and did not cite the other cases. Furthermore, the court did not cite Regulation Section 1.162-17 or mention the fact that such Regulation expressly states that reimbursed expenses for the benefit of an employer need not be reported if the employee accounts for them to his employer.

But appellees believe the *Warwick* case is otherwise well-reasoned and the result is certainly consistent with the other authorities which appellees rely upon. Indeed, the court in *Gotcher v. United States supra,* states, as an alternative ground for its decision, that if the reimbursed expenses were includible in the taxpayer's income, they were deductible. A similar alternative ground was stated in the dissenting opinion of Justices Douglas and Black in *Rudolph v. United States, supra.* See also *Mertens, Law of Federal Income Taxation,* Section 6.04, Ch. 6, pp. 17-18.

The real significance of the *Warwick* case is that it again illustrates the Government's misconception and

misconstruction of the "business purpose" that is required for reimbursed travel expenses of the wife to be non-taxable. Appellant erroneously contends in its brief that Mrs. Disney's travel is not an ordinary and necessary business expense of Mr. Disney unless she actually performed business services for her husband; and that her enhancement of WDP's image does not qualify. (Br. pp. 17-19.) Apparently, appellant would limit the type of services which qualify to secretarial duties or actual participation in business negotiations or discussions. *Warwick,* along with *McDonell* and *Gotcher,* discussed previously, conclusively refute any such notion.[9]

Nor is there anything in the regulations or other authorities cited by appellant which support the narrow distinction it urges here. Obviously, one of Mr. Disney's duties on the trips for the company is to maintain good will and promote WDP's corporate image as a disseminater of wholesome family entertainment. His travel and entertainment on behalf of the company included attending shows, press conferences and social engagements with business contacts. His own reimbursed expenses incurred for that purpose would unquestionably be business expenses if they were required to be included in his income. Reg. Section 1.162-17. The District Court found that Mrs. Disney's presence on the trips assisted him in the performance of those duties. Hence, the court correctly

[9]Appellees have already shown in the preceding section of this brief that the courts have rejected the government's argument that the taxpayer must prove the reimbursed expenses were proximately related to his personal business, as distinguished from his employer's business in the pursuance of which the expenses were incurred. See, *e.g., William R. Lickert,* 23 T.C.M. 376, 380 (1964); *Homer H. Starr,* 46 T.C.M. 743, 745 (1966).

found that her presence on the trips served a bona fide business purpose within the meaning of Regulation, Section 1.162-2(c) and Rev. Rule 55-57, 1955 C.B. 315. It follows that her reimbursed travel expenses are just as much a business expense to Mr. Disney as are his own if they are required to be included in income.

The case of *Sheldon v. Commissioner,* 299 F. 2d (7th Cir. 1962), relied upon by appellant on this point, is patently inapposite. In the first place, that case did not involve the treatment of reimbursed travel expenses paid by an employer. Rather, the taxpayer-husband was seeking to deduct his wife's travel expenses which he paid out of his own pocket. Obviously, to obtain the deduction, he had to show some connection with his own business. The court said this was a question of fact and found that the wife's activities on the trip were primarily social with insufficient evidence of any business connection. Unlike the instant case, it was not shown that the wife's travel and social activities had a bona fide business purpose—to the husband or his employer.

Conclusion.

For the foregoing reasons, appellant's position on appeal must be rejected and the District Court's decision should be affirmed. The findings of a bona fide business purpose for Mrs. Disney's presence on the trips, and that payment of her expenses by WDP was not compensation, precluded the inclusion of such payments in appellees income under the better reasoned authorities and the Commissioner's own regulations.

But even if appellant were correct in its first argument, that Mrs. Disney's reimbursed travel expenses should have been included in appellees gross income, they were deductible and appellees would still be entitled to the refund provided for in the District Court's Judgment.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

JACK R. WHITE